Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Cogdill Analyst: Roger Lackey Bill Number: AB 475

Related Bills: See Prior Analysis Telephone: 845-3627 Amended Date: May 10, 2001

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Qualified Wage Credit

____	DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ______________________.
X	AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
X	AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended April 26, 2001.
X	FURTHER AMENDMENTS NECESSARY.
____	DEPARTMENT POSITION CHANGED TO ______________________.
X	REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 26, 2001, STILL APPLIES.
____	OTHER - See comments below.

SUMMARY

This bill would allow a small business that is located in a qualified area a credit based on a percentage of employees' wages.

SUMMARY OF AMENDMENTS

The May 10, 2001, amendments:

- Limit the eligibility of the credit to employers with gross receipts of $10 million or less.
- Revise "qualified wages" to mean an increase in the minimum wage may only be used as a basis for computing qualified wages for no more than five years.
- Require that the unemployment rate used to determine eligibility for the credit would be the annual average statewide unemployment rate from the year immediately preceding the year in which the qualified wages were paid.
- Revise the meaning of "eligible employee" to include that an employee be paid by a qualified employer in a qualified area, and that an eligible employee does not include anyone paying wages to himself or herself.
- Reduce the credit carryover period from 15 years to 8 years.
- Prohibit any other credit from being claimed for any qualified wages used to calculate the credit, and affirm that no deduction would be allowed for the qualified wages by deleting "may" and inserting "shall."
- Require the Franchise Tax Board on or before January 1, 2004, and annually thereafter, to report to the Legislature regarding the utilization of the credit.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP	Brian Putler	05/22/01
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X N	____ OUA	____ PENDING		

The proposed amendments would resolve a number of the implementation, technical, and policy considerations. The remaining implementation and policy considerations are included below, along with a new tax revenue estimate.

Except for the discussion above, the department's analyses of the bill as introduced February 21, 2001, and amended April 26, 2001, still apply.

POSITION

Neutral.

At its May 2, 2001, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill, with Annette Porini, on behalf of Member B. Timothy Gage, abstaining.

IMPLEMENTATION CONCERNS

This bill would define "qualified employee" and require an employee to be paid by a qualified employer in a qualified area. However, the bill is silent in regard to defining employer and whether the employer's business location and or business activities must occur in the qualified area. As a result, this bill could be interpreted in a number of different ways that may include taxpayers not intended by the author and may exclude employee wages that should qualify. The author should consider clarifying the term "qualified employee" and defining the term "employer" for purposes of this bill to resolve any ambiguities.

Rather than state that an "eligible employee" shall not include any person that pays wages to himself or herself, the author may want to require that an eligible employee not include any self-employed individual. This may be more effective since many self-employed individuals do not receive actual wages.

It is unclear whether an eligible employee is determined by reference to a specified number of employee hours worked or if it is the number of actual persons employed at any given time during the taxable year.

ECONOMIC IMPACT

Tax Revenue Estimate

The department's previous revenue estimate provided in the department's analysis of the bill as amended April 26, 2001, was incorrect. That revenue estimate erroneously valued the increase in the minimum wage at $1, when the actual increase effective for the bill would be 50 cents. As a result, the new revenue estimate is provided.

This bill would impact PIT and B&CT revenues as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2001 Enactment Assumed After June 30, 2001 $ Millions			
2001-02	2002-03	2003-04	2004-05
-$15	-$135	-$195	-$225

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The revenue impact for this bill will be depend upon the number of qualified employers located in certain high unemployment counties, the number of employees making less than twice the minimum wage per hour, the amount of wage differentials paid, and the amount of available tax liabilities of qualified employers.

This estimate was developed in the following steps. First, according to statistics from the Employment Development Department (EDD), there are approximately 16.5 million individuals employed in the State of California, which 1.8 million are employed in counties that have at least 150% the California unemployment rate as of January 1, 2001 (4.5%). This number was adjusted downward to reflect those employed by government entities and those making more than $13.50 per hour, leaving 626,000 qualified individuals. Second, based on the same source, the average weekly hours worked is approximately 30 hours, or 1,500 hours annually. Third, according to the Industrial Welfare Commission, the current minimum wage as of December 31, 2001 is $6.25 an hour and will increase to $6.75 an hour as of January 1, 2002, **a $0.50 per hour increase**. Multiplying these three elements, the total generated credit amount for tax year 2002 is projected to be approximately $469.5 million. This number was further adjusted downward to reflect eligible businesses (i.e. less than 100 employees) and current law deductions, leaving $431 million in generated credits for tax year 2002. It was assumed that on average, 33% of generated credits would be applied against available tax liabilities in the first tax year. The low usage rate was used because of the rather high credit amount generated by employers potentially.

ARGUMENTS/POLICY CONCERNS

This bill would allow employers to claim a credit for employees who are relatives of the taxpayer.

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